84-186 (1)

No. 84-

IN THE
Supreme Court of the United States
OCTOBER TERM, 1984

ASSOCIATION OF OIL PIPE LINES,
Petitioner,

v.

FARMERS UNION CENTRAL EXCHANGE, INC., *et al.*,
FEDERAL ENERGY REGULATORY COMMISSION, and
UNITED STATES OF AMERICA,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

CHARLES E. GRAHAM
JOHN E. COMPSON
KENNETH P. FOUNTAIN
JAMES R. KINZER
HARRY L. REED

SIDLEY & AUSTIN
Of Counsel

August 2, 1984

R. EDEN MARTIN *
LAWRENCE A. MILLER
VINCENT F. PRADA
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

PATRICK H. CORCORAN
1725 K Street, N.W.
Washington, D.C. 20006

Attorneys for Petitioner Association of Oil Pipe Lines

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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QUESTIONS PRESENTED

I.

In the decision reviewed by the Court of Appeals below, the Federal Energy Regulatory Commission ("Commission" or "FERC") established a new methodology for the regulation of oil pipeline rates. Under that methodology, which is different from the methodology that has traditionally been applied to public utilities, oil pipeline rates would be regulated to reflect the current values of oil pipeline assets and the returns that investors in oil pipelines can realize elsewhere in the economy. The Commission determined that this value-based methodology was appropriate for the regulation of oil pipeline rates, in preference to a cost-based, public utility methodology, because of the competitive, market-oriented nature of the oil pipeline industry, its regulatory history, and the basic purposes that its continued regulation should serve.

The first question presented is whether the Court of Appeals exceeded the proper scope of review in setting aside the Commission's decision on the grounds that the Commission erred in failing to apply the cost-based concepts that have evolved in the regulation of public utilities—concepts *assumed* by the Court of Appeals to be valid for the regulation of any industry regardless of whether its basic economic characteristics are the same as those of public utilities.

II.

In the decision reviewed by the Court of Appeals below, the Federal Energy Regulatory Commission held that oil pipelines must be permitted to compute income tax expense for regulatory purposes at the statutory tax rate, notwithstanding that income tax actually paid during the earlier years of an asset's life may be lower than the statutory rate if the carrier has elected to use accelerated depreciation for income tax purposes (just as

income taxes actually paid during the later years may be higher than the statutory rate). However, the Commission also ruled that if a carrier elects thus to "normalize" tax-timing differences, it must deduct the accumulated deferred tax amounts (*i.e.*, the difference between the amounts that would be payable at the statutory rate and the accumulated amounts actually paid) from its rate base, disregarding unrebutted evidence that the effect of requiring this deduction is the same as denying oil pipelines the right to "normalize" their tax expenses in the first place.

The second question presented is whether the Court of Appeals erred in affirming the Commission's decision requiring the rate base deduction of accumulated deferred tax amounts.

RULE 21.1(b) STATEMENT

The following parties appeared in the proceedings before the Court of Appeals below:

Association of Oil Pipe Lines
Williams Pipe Line Company
ARCO Pipe Line Company
Belle Fourche Pipe Line Company
Buckeye Pipe Line Company
Getty Pipeline, Inc.
Hydrocarbon Transportation, Inc.
Marathon Pipe Line Company
Mid-America Pipeline Company
Phillips Pipe Line Company
Sun Pipe Line Company
Texas Eastern Transmission Corporation
Farmers Union Central Exchange, Inc.
Farmland Industries, and its subsidiary CRA, Inc.
Kerr McGee Refining Corporation
Land O'Lakes, formerly Midland Cooperatives, Inc.
National Cooperative Refining Association
Federal Energy Regulatory Commission
United States of America

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v.

FARMERS UNION CENTRAL EXCHANGE, INC., *et al.*,
FEDERAL ENERGY REGULATORY COMMISSION, and
UNITED STATES OF AMERICA,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner, the Association of Oil Pipe Lines ("AOPL"),[1] hereby requests that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered on March 9, 1984, setting aside a decision of the Federal Energy Regulatory Commission ("Commission" or "FERC") establishing a methodology for regulating the rates of common carrier oil pipelines.

OPINIONS BELOW

The opinion of the Court of Appeals, styled as *Farmers Union Central Exchange, Inc.* v. *FERC*, is reported at 734 F.2d 1486, and appears as Appendix A. The opinion

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[1] AOPL is an unincorporated association of some 100 common carrier oil pipelines whose members transport over 95 percent of all crude oil and petroleum products moved by pipeline in the United States. AOPL participated in the proceedings before the Court of Appeals below both as Petitioner and Intervenor-Respondent and in the administrative proceedings reviewed by the Court of Appeals.

of the FERC reviewed by the Court of Appeals is reported at 21 FERC (CCH) ¶ 61,260, and appears as Appendix B.

JURISDICTION

The judgment of the Court of Appeals was entered on March 9, 1984. Timely Petitions for Rehearing and Suggestions for Rehearing *En Banc* filed by AOPL, *et al.*, were denied on May 4, 1984 (*see* App. D). Jurisdiction of this Court is invoked under 28 U.S.C. §§ 1254 and 2350.[2]

STATUTORY PROVISIONS INVOLVED

The statutes involved are the Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*, and the Interstate Commerce Act, 49 U.S.C. §§ 1 *et seq.*[3] Pertinent provisions of these statutes are set forth in Appendix E.

STATEMENT OF THE CASE

This case involves a decade-long controversy before the FERC and its predecessor, the Interstate Commerce Commission ("ICC"), as to the appropriate methodology for regulating oil pipeline rates under the "just and reasonable" standard of the Interstate Commerce Act (49 U.S.C. § 1(5)(a)). In late 1982, after more than four years of proceedings, the FERC issued its decision adopting a regulatory methodology for the oil pipeline indus-

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[2] 28 U.S.C. § 2350, which governs petitions for certiorari in proceedings to review decisions of the Interstate Commerce Commission (*see* 28 U.S.C. § 2341), is also applicable to petitions for certiorari in proceedings to review FERC decisions involving oil pipelines. *See* 42 U.S.C. § 7192(a); *Earth Resources Co. of Alaska* v. *FERC*, 628 F.2d 234, 235 (D.C. Cir. 1980).

[3] The Interstate Commerce Act as applicable to common carrier oil pipelines is the Act as it existed on October 1, 1977, when the Department of Energy Organization Act (Pub. L. No. 95-91) became effective. *See* Pub. L. No. 95-473, § 4(c), 92 Stat. 1337, 1340 (1978). Hence, the provisions of the Interstate Commerce Act applicable to oil pipelines are the provisions of the Act as amended by the Railroad Revitalization and Regulatory Reform Act of 1976 (Pub. L. No. 94-210), but before the recodification of the Act in 1978 (Pub. L. No. 95-473).

try. On review of the FERC's decision, the Court of Appeals rejected virtually every aspect of that methodology, and remanded the case for yet further proceedings before the FERC.

To understand the important questions raised by the Court of Appeals' decision, a brief review of the procedural history of this case is necessary.

1. Initial Proceedings Before the Interstate Commerce Commission in the *Williams* Case

This proceeding originated in rate filings made by Williams Pipe Line Company (then Williams Brothers Pipe Line Company) in late 1971 and early 1972. Certain shippers that use Williams' pipeline system protested these rate increases under Section 15(7) of the Interstate Commerce Act, and also complained as to other Williams rates. Following evidentiary proceedings before an Administrative Law Judge ("ALJ") and review proceedings before a three-Commissioner Division of the ICC, the full Commission in 1976 concluded that the challenged rates yielded returns on the valuation of the company's common carrier facilities that fell within the guideline rates of return established by the ICC in the early 1940's. On this basis, the ICC ruled that the challenged rates were just and reasonable under the Act. The ICC specifically rejected the contention that the appropriate basis for assessing the reasonableness of Williams' rates was the "original cost" of its assets rather than their valuation. *See* 351 I.C.C. 102 (1975), *aff'd,* 355 I.C.C. 479 (1976). Thus, after some four years of proceedings, the ICC decided to adhere to its established valuation methodology.

2. The Court of Appeals' Decision in *Farmers Union I*

The complaining shippers sought review of the ICC's decision in the Court of Appeals for the District of Columbia Circuit. *Farmers Union Central Exchange, Inc.* v. *FERC,* 584 F.2d 408 (D.C. Cir.), *cert. denied,* 439

U.S. 995 (1978) (*"Farmers Union I"*). In its opinion, the Court of Appeals expressed its "unease with the ICC's findings regarding rate base, rate of return, and depreciation costs" (*id.* at 421), because of the "prominent" or "total emphasis" the ICC had placed on its "1940's precedents" (*id.* at 418, 419), without adequately explaining and justifying its established valuation approach under current conditions.

The Court of Appeals did not, however, conclude that the ICC's decision sustaining the reasonableness of Williams' rates was erroneous, nor did it hold that the valuation methodology utilized by the ICC could not be supported by adequate findings. Instead, noting that jurisdiction over oil pipeline rates had recently been transferred to the FERC during the pendency of the review proceedings, and that the new agency had requested that the proceedings be remanded to it "so that it can formulate, independently to the ICC, the regulatory principles it finds to be suitable for application in this new area of responsibility committed to it" (*id.* at 410), the Court of Appeals remanded the case to the FERC to allow that agency "to attempt for itself to build a viable modern precedent for use in future cases" (*id.* at 421).

In so ruling, the Court of Appeals admonished the FERC that nothing in the Interstate Commerce Act or its history required the imposition of a public utility methodology in regulatory proceedings involving the rates of oil pipelines (*id.* at 413):

> "[W]e may infer a congressional intent to allow a freer play of competitive forces among oil pipeline companies than in other common carrier industries and, as such, we should be especially loath uncritically to import public utilities notions into this area without taking note of the degree of regulation and of the nature of the regulated business."

The Court of Appeals thus left it to the new agency, the FERC, to develop a regulatory approach for oil pipelines in light of the "freer play of competitive forces," the "de-

gree of regulation," and the "nature of the regulated business."

3. Proceedings on Remand Before the Federal Energy Regulatory Commission

By order issued February 23, 1979, the FERC reopened the remanded case and assigned it to an Administrative Law Judge ("ALJ"). The presiding ALJ ordered that the proceeding be structured in two phases: Phase I, described by the ALJ as a "rulemaking proceeding," was intended to address the ratemaking principles applicable to the oil pipeline industry generally.

This proceeding resulted in the development of a massive record exploring the nature and characteristics of the oil pipeline industry. The parties filed verified statements of over 50 witnesses, totalling some 4,000 pages. Lengthy rebuttal statements were also submitted. Fifty-nine days of hearings were conducted for the purpose of cross-examining these witnesses. In all, the record includes over 500 exhibits and over 8,000 pages of transcript. The Commission heard oral argument on June 30, 1980, and reargument on November 19, 1981.

4. The Federal Energy Regulatory Commission's Decision

After lengthy deliberations, the FERC issued its decision in Phase I on November 30, 1982. Opinion No. 154, *Williams Pipe Line Co.,* Docket No. OR79-1-000, 21 FERC (CCH) ¶ 61,260 (App. B-1). The FERC's decision was described by a Commission press release as "the longest and most elaborate that the Commission has ever issued" (News Release, FE-1229, November 30, 1982, at 6).

Consistent with the decision of the Court of Appeals in *Farmers Union I,* the FERC carefully examined the intent of Congress in making oil pipelines subject to common carrier regulation. Based on its examination of the legislative history of the Hepburn Act, the structure of the regulatory scheme applicable to oil pipelines, and current economic conditions—including the *de minimis*

impact of oil pipeline rates on the ultimate consumers of petroleum products, the demonstrated need for greater investment in oil pipeline capacity, and the existence of effective competition—the FERC concluded that an interventionist form of regulation patterned upon cost-based public utility regulation is not appropriate for this industry.

Instead, the FERC found that a more flexible regulatory approach utilizing a valuation rate base and rate of return concepts based on a commercial standard of reasonableness is appropriate for the oil pipeline industry and will best promote the objectives embodied in the "just and reasonable" standard. The FERC thus essentially confirmed the judgment of its predecessor agency, the ICC, as to the kind of regulatory methodology which is best suited to this competitive industry.

The FERC first exhaustively examined the provisions and history of the Hepburn Act of 1906, which for the first time subjected oil pipeline rates to regulation under the "just and reasonable" standard of the Interstate Commerce Act. The FERC concluded that the purpose of the Hepburn Act was not to protect consumers from the effects of excessive pipeline rates but to assure nondiscriminatory access to oil pipeline transportation for oil producers who could not afford to build their own pipelines (App. B-124 to 128). Thus, FERC determined that the nature of oil pipeline regulation contemplated by Congress in 1906 was not what has subsequently evolved as traditional public utility regulation, and that the purpose of oil pipeline regulation is fundamentally different from the purposes of public utility regulation (App. B-128).

The FERC also found support for its commercial standard of reasonableness and valuation-based approach in the structure of regulation applicable to oil pipelines. Unlike public utilities (and other common carriers regu-

lated under the Act), there are no statutory restrictions on entry into and exit from the industry protecting oil pipelines from competition. Oil pipelines thus require market incentives not only to attract, but also to retain, capital in oil pipeline assets, which might otherwise be abanoned prematurely (App. B-285). The FERC concluded that the "monopolistic franchises and legally protected shelter from . . . competition" enjoyed by public utilities are a "quid pro quo" for a "rigorous," "cost-based" regulatory methodology (App. B-104 to 107). Absent such a *quid pro quo* in the case of oil pipelines, the FERC rejected a public utility ratemaking methodology in favor of a commercial standard of reasonableness, based on asset valuation rather than original cost.

The FERC also found significant actual and potential competition in the oil pipeline industry, further strengthening its decision to depart from a strict cost-based methodology (App. B-163 to 167). The effects of this competition, the FERC found, have been evidenced in low oil pipeline rates and an almost total lack of shipper complaints (App. B-150, B-163).

In addition, the FERC concluded that oil pipeline rates have a *de minimis* impact on consumers because pipeline transportation costs have constituted a minute and diminishing share of the total cost of petroleum products and because market prices for petroleum products "are influenced by such a variety of forces and factors that a pipeline rate increase (or for that matter a decrease) can well be rendered inaudible by, if not wholly lost in, the surrounding 'noise'" (App. B-63 to 64, B-92 to 93). The FERC also recognized that, in light of the nature of oil pipelines and their relation to the consumer, a more serious threat would be posed to consumer interests by allowing returns which were too low. If allowable returns were too low, consumers would not only reap no tangible benefit because of the "submicroscopic" impact of oil pipeline rates upon the market prices of petroleum

products, but would ultimately suffer if such returns precluded the construction of needed new pipeline facilities (App. B-177 to 179). Noting that "[e]verybody agrees that the nation needs and will need more pipeline plant," and that the "worrisome thing here is underinvestment" (App. B-178), the FERC ruled that, on balance, the public interest calls for a regulatory methodology based on asset valuations and a commercial standard of reasonableness.

Finally, the FERC found that the "transitional questions" that a radical switch in rate methodology would entail would create a "serious problem" (App. B-213). Such a switch would unfairly frustrate investor expectations, without any clear countervailing benefits (App. B-215 to 218), and would also result in competitive dislocations and a disincentive to construct new facilities because of the "front-end load" (the allocation of higher capital costs to the early years of the asset's life) which an original cost approach would impose upon the rates of newer lines (App. B-210 to 227).

For all of the foregoing reasons, despite its open acknowledgement of a "strong predisposition" in favor of the original cost methodology, the FERC adhered to a valuation methodology as being most appropriate for the oil pipeline industry.

Under the rate of return methodology adopted by the FERC, oil pipelines would be allowed an opportunity to earn a " 'real' entrepreneurial rate of return on the equity component of the valuation rate base," to be determined using a comparable earnings analysis keyed to alternative investments available to the owners of oil pipeline assets (App. B-271 to 275). The FERC reasoned that oil pipeline investors, which are typically affiliates of oil or other energy-related companies, do not have the same aversion to risk as do investors in public utilities—

i.e., they are accustomed to making investments in relatively risky assets in the market sector of the economy. When they make such investments they expect the opportunity to earn returns commensurate with the risks involved. Thus, if oil pipeline investors were denied an opportunity to realize returns on oil pipeline assets comparable to the opportunities available in alternative investments, new pipeline facilities would not be constructed in response to changing patterns of supply and demand for petroleum, and existing facilities might be abandoned prematurely (App. B-274 to 278).

In its decision, the FERC also addressed the appropriate treatment of Federal income taxes for regulatory purposes. For the purpose of determining income tax expense, the FERC held that oil pipelines should be permitted to "normalize" tax timing differences resulting from accelerated depreciation—*i.e.*, to compute such expenses on the basis of the statutory rate rather than on the basis of taxes actually paid in a given year. However, the FERC ruled that if normalization is elected by a carrier, a deduction *must* be made to eliminate the deferred tax amounts from the rate base.

5. The Court of Appeals' Decision in *Farmers Union II*

In a 92-page opinion issued on March 9, 1984, the Court of Appeals set aside the FERC's decision, rejecting the regulatory methodology adopted by the FERC both in its basic approach and in the details of its implementation. However, the Court of Appeals upheld the FERC's resolution of the tax normalization issue.

After reviewing the FERC's opinion and setting forth the applicable standard of review, the Court of Appeals proceeded to examine, and to reject, virtually every aspect of the FERC's decision to adopt a regulatory methodology different from the cost-based methodology traditionally employed in the regulation of public utilities—including its use of a valuation rate base and its adoption of an entrepreneurial rate of return methodology.

In the Court of Appeals' view the principal defect in the FERC's decision was its failure adequately to justify its departure from traditional, cost-based, public utility ratemaking principles. Summarizing its principal conclusions, the Court of Appeals criticized the FERC for relying on "presumed market forces" as "the principal regulatory restraint" (App. A-92), and admonished that "[d]epartures from cost-based rates must be made, if at all, only when the non-cost factors are clearly identified and the substitute or supplemental ratemaking methods ensure that the resulting rate levels are justfiied by those factors" (*id.*). The Court of Appeals directed the FERC on remand to "reexamine" the original cost methodology which the court described as "a proven alternative" (*id.*).

On the tax normalization question, the Court of Appeals affirmed the FERC's decision to prohibit companies that choose tax normalization accounting from including the resulting deferred tax amounts in their rate base, holding that this treatment of deferred taxes would not eliminate the benefits otherwise resulting from an oil pipeline's election of accelerated depreciation (App. A-90 to 91).

REASONS FOR GRANTING THE WRIT

I. THE ISSUES PRESENTED ARE OF MAJOR SIGNIFICANCE TO THE ENERGY FUTURE OF THE UNITED STATES

The ultimate issue presented in this case is whether oil pipelines are to be regulated in a manner which the FERC, after a lengthy and exhaustive inquiry, has concluded is appropriate in light of the basic economic characteristics of the industry. The resolution of this issue is obviously of great importance, both as a matter of legal principle and because of its practical consequences for a multi-billion dollar industry and its customers. The regulatory methodology which is finally adopted in these proceedings—whether by the informed judgment of the FERC or by judicial fiat—will have a crucial impact on an important sector of the economy for decades to come.

Moreover, resolution of the basic issue in this case will irrevocably affect the public interest in a reliable, economical and efficient mode of transportation for an important source of energy. Absent a stable regulatory environment suited to the economic nature of the industry, even the Nation's oil companies—traditionally the principal investors in pipeline capacity—cannot be expected to commit the capital that is needed to meet new demand (particularly in high-risk, frontier areas) or to retain their existing investments in oil pipeline assets. Absent such an environment there will be even less reason for independent pipeline companies, an important part of this industry, to continue to invest in oil pipeline facilities.

The regulatory methodology based on asset valuation that has been in place for over 40 years is well suited to the economic characteristics of the industry. As a result, the industry has grown to meet demand, investments have been made in pioneer projects in arctic and offshore areas such as the Trans Alaska Pipeline System, and shipper complaints have been virtually nonexistent.

When it assumed jurisdiction over the oil pipeline industry, the FERC undertook a reevaluation of the established oil pipeline regulatory methodology—an undertaking which the Court of Appeals endorsed when it remanded this case to the FERC in 1978. However, in so doing, the Court of Appeals made it clear that the FERC was to formulate "regulatory principles it finds to be suitable for application in this new area of responsibility committed to it." *Farmers Union I*, *supra*, 584 F.2d at 410. Indeed, the court was emphatic that Congress intended "to allow a freer play of competitive forces among oil pipeline companies than in other common carrier industries" (*id.* at 413), and that it therefore "should be especially loath uncritically to import public utilities notions into this area without taking note of the degree of regulation and of the nature of the regulated business" (*id.*).

The FERC's decision, issued after over four years of proceedings and deliberations, is founded on precisely the considerations identified by the Court of Appeals in *Farmers Union I*—the intent of Congress in regulating oil pipelines, the degree of regulation, and the competitive nature of the regulated business. As explained above, these considerations led the FERC to conclude that an original cost, public utility regulatory methodology should *not* be applied to this industry.

However, according to the Court of Appeals' subsequent decision in *Farmers Union II*, the underlying premise of these conclusions—the premise mandated by the Court of Appeals in *Farmers Union I*—is faulty. The Court of Appeals has now told the FERC that what it should have done in the proceedings on remand from *Farmers Union I*, and what it must do now, is to proceed, not based on its own assessment as to the competitive nature of the industry and Congress' purpose in subjecting it to regulation under the Interstate Commerce Act, but based on a presumption that a cost-based, public utility methodology is the only valid means for regulating this or any other industry. It is further told that it may depart from such a cost-based methodology only upon the most exacting findings and analysis.

AOPL submits that the Court of Appeals' mandate to the FERC in *Farmers Union I* cannot be reconciled with its mandate to the Commission in *Farmers Union II*, and that the resulting confusion and uncertainty after over a decade of litigation seriously jeopardizes the ability of oil pipelines to attract and maintain investment capital, and thus imperils the future of an important part of the Nation's energy and economic infrastructure. For this reason alone, this Court should grant the writ and review the decision of the Court of Appeals.

II. THE COURT OF APPEALS SERIOUSLY TRANSGRESSED THE PROPER BOUNDS OF JUDICIAL REVIEW OF AGENCY RULEMAKING

A. The Applicable Scope of Review

The FERC's order adopting a methodology for oil pipeline ratemaking is an agency rule subject to review under the Administrative Procedure Act. Accordingly, the agency's decision could be set aside by the Court of Appeals only if that decision was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" (5 U.S.C. § 706(2)(A)). The Court of Appeals purported to apply this standard of review (App. A-24 to 29).

Judicial review of administrative action under the "arbitrary and capricious" standard is, under settled and familiar principles, both very narrow in scope and highly deferential to the expert judgment of the agency. The reviewing court is not empowered to substitute its own judgment for that of the agency. *Motor Vehicle Manufacturers Association of the United States, Inc.* v. *State Farm Mutual Automobile Insurance Co.*, 103 S. Ct. 2856, 2866 (1983); *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 416 (1971); *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 615 (1944). Rather, the court's limited function is to determine whether the agency's decision was based on a consideration of the relevant factors and whether the agency articulated a rational connection between the facts found and the choice made. *Motor Vehicle Manufacturers, supra*, 103 S. Ct. at 2866-67; *Bowman Transportation, Inc.* v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285 (1974); *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168 (1962).[4]

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[4] If the agency's decision satisfies this standard, the reviewing court must uphold it, even if the court would not have reached the same decision as the agency in the first instance. *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519, 558 (1978). Moreover, a reviewing court is not authorized to upset an agency's

These limiting principles apply with particular force in the context of agency ratemaking under a statutory mandate to insure "just and reasonable" rates. Judicial review of rate orders is "extremely limited." *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 306 (1974). *See also Permian Basin Area Rate Cases*, 390 U.S. 747, 766 (1968) (characterizing judicial review as "essentially narrow and circumscribed").

Accordingly, this Court has ruled that in formulating methods of regulation to insure just and reasonable rates, "no single method need be followed by the Commission. . . ." *Wisconsin* v. *FPC*, 373 U.S. 294, 309 (1963). *See also Hope Natural Gas, supra*, 320 U.S. at 602 ("[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling"). Rather, the ratemaking agency is free to devise methods of regulation capable of equitably reconciling diverse and conflicting interests. *Permian Basin, supra*, 390 U.S. at 767. Moreover, on several occasions this Court has affirmed the principle that an agency, in pursuit of its divergent objectives, may depart from a rigid, cost-based methodology based on the original cost of the regulated entity's assets. *See, e.g., FERC* v. *Pennzoil Producing Co.*, 439 U.S. 508 (1979); *Federal Power Commission* v. *Texaco, Inc.*, 417 U.S. 380 (1974); *Mobil Oil, supra.*

B. The Court of Appeals' Transgression of These Principles

As set forth below, the Court of Appeals clearly exceeded the scope of its proper function on review in violation of the foregoing principles. In its decision, the FERC *acknowledged* that the issues involved are both

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policy judgments under the guise of requiring a fuller explanation of the agency's reasoning: the court must "uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned." *Bowman, supra*, 419 U.S. at 286. Thus, reviewing courts owe considerable deference to the expert judgment of administrative bodies entrusted with specialized functions by Congress.

difficult and complex, and candidly explained why it believed there are no clear or easy choices among the alternative policies and methodologies that could be adopted for the regulation of this unique industry. The FERC also carefully explained why it adopted the policy and methodology it did, and why it rejected alternative approaches.

Far from according deference to the judgment of the agency on these inherently controversial matters, the Court of Appeals virtually retried the matter that had been before the FERC for some five years—second-guessing the inferences drawn by the FERC from the voluminous evidence of record as to the nature of the oil pipeline industry, reevaluating the alternatives of policy and methodology that the FERC had carefully addressed, and restriking the balance of interests carefully struck by the FERC.

Although cast in terms of the applicable principles of judicial review, the Court of Appeals' decision does not stop at an assessment of whether the FERC had adequately considered the matters and issues before it in reaching its judgments and conclusions. Instead, by a reading of the FERC's decision that almost totally disregards the substance and intent of the agency's effort to establish a regulatory methodology that is appropriate to this unique industry, the Court of Appeals substituted its judgment for that of the FERC as to both the basic approach to be used in regulating oil pipeline rates and the appropriate implementation of that approach.

The Court of Appeals found unacceptable virtually every aspect of the FERC's decision to adopt a regulatory methodology for competitive oil pipelines which is different from the traditional methodology used in the regulation of monopoly public utilities. Elevating the rhetoric (and occasional hyperbole) of the FERC's decision over its manifest intent, and making an unwarranted presumption that public utility ratemaking concepts are somehow mandated by law, the Courts of Appeals im-

properly concluded that, by adopting different concepts for oil pipelines, the FERC had in effect deregulated oil pipeline rates in contravention of the "just and reasonable" requirement. In so concluding, the Court of Appeals supplanted the careful adjustments of competing policies and interests made by the FERC and substituted its own judgment for that of the FERC as to the regulatory approach appropriate for this industry.

First, the Court of Appeals found that adoption of a commercial standard of reasonableness was tantamount to "virtual deregulation" in excess of the FERC's authority under the "just and reasonable" standard (App. A-43). The Court of Appeals found that a methodology keyed to "prohibitive pricing" was by definition not one which would produce "just and reasonable" rates, and identified as a "fundamental flaw" in the FERC's methodology the purported absence of anything in the regulatory scheme itself to insure that rates would in fact be held below the ceilings of maximum reasonableness and within the zone of reasonableness (App. A-48).

The Court of Appeals' condemnation of the FERC's standard of reasonableness is the product of a serious misreading of the FERC's decision that blatantly disregards both its intent and effect. The "exploitation, abuse, overreaching or gouging" of which the FERC spoke *would be prohibited* by the chosen standard of reasonableness and would *not* result, as the Court of Appeals erroneously believed, from rate levels that the methodology would *permit.* The Court of Appeals simply failed to recognize that, unlike deregulation, the commercial standard of reasonableness imposes finite limits—described by the FERC as "ceilings" (App. B-283)—on the rates oil pipelines may charge. Contrary to the erroneous conclusion of the Court of Appeals, the FERC did *not* equate reasonable oil pipeline rates with whatever the market would bear. Instead, the FERC decided that *within the constraints* set by its regulatory ceilings, it would place principal reliance on market forces and competition to

produce reasonable rates.[5] This decision to rely in part on market forces is well within the FERC's authority, *see, e.g., Federal Power Commission* v. *Texaco, Inc.*, 417 U.S. 380 (1974), and was not equivalent to total deregulation of oil pipeline rates.

Second, the Court of Appeals improperly intruded upon the discretion of the FERC in upsetting the careful balance the FERC sought to achieve between the interests of consumers and the interests of investors. In *Hope Natural Gas, supra*, 320 U.S. at 603, this Court stressed that ratemaking agencies must undertake such a balancing of interests. In an effort to discharge its responsibilities, the FERC found, as noted above (pp. 7-8, *supra*), that a lowest-cost, public utility ratemaking methodology is not necessary to protect consumer interests because the impact of transportation costs on the total bill for petroleum products is miniscule, and because this *de minimis* impact on consumers is greatly outweighed by the need for a rate methodology that will insure needed pipeline investment (App. B-63 to 64, B-92 to 93, B-144 to 149). The objective of encouraging investment in new facilities has often justified a departure from lowest-cost, public utility ratemaking principles, *see, e.g., American Paper Institute, Inc.* v. *American Electric Power Service Corp.*, 103 S. Ct. 1921 (1983), and the FERC in the instant case concluded that it warranted adoption of a commercial standard of reasonableness and a valuation-based rate methodology.

The Court of Appeals usurped this balance and found the FERC's discussion defective. The Court of Appeals inexplicably ruled that consumer impact was irrelevant (App. A-43 to 44), notwithstanding the well-established

[5] However, the FERC made clear that its processes would be available to shippers, prospective shippers, dealers in oil, state and local governments and "*anybody* who asserts some semblance of an interest in the matter, as entrepreneur, as consumer, or as citizen" (App. B-174) (emphasis in original). Thus, aggrieved shippers and other interested parties would in no way be precluded from challenging oil pipeline rates as excessive or unfair.

requirement in this Court's decisions to consider such interests and balance them against other competing interests and policies. The Court of Appeals also refused to accept FERC's objective of encouraging additional investment in pipeline facilities because, in the court's opinion, the FERC did not sufficiently "calibrate" the investment need with the chosen rate levels (App. A-34). The Court of Appeals' imposition of a requirement of precise "calibration" went far beyond the proper scope of review; the FERC's careful weighing of consumer interests and investor/public service interests is clearly one of those "practical adjustments" that are entrusted to the expert agency and not to the courts. *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942). Moreover, the Court of Appeals failed to recognize that precise "calibrations" of investment needs and rate levels were unnecessary here because the countervailing consumer interests were so slight. Thus, by improperly divorcing the two sides of the balance, the Court of Appeals failed to give proper deference to the FERC's genuine and thoughtful attempt to "formulate methods of regulation appropriate for the solution of its intensely practical difficulties." *Permian Basin, supra*, 390 U.S. at 790.

Third, the Court of Appeals erred in rejecting the FERC's policy decision to place substantial, although not complete, reliance on market forces in establishing reasonable rates for oil pipelines. Even in the context of traditional public utilities, the authority for placing such reliance on competitive market forces is well settled. *See, e.g., American Paper Institute, supra*; *Federal Power Commission* v. *Texaco, supra.* In addition, the Court of Appeals in *Farmers Union I* had laid particular emphasis on the need for a "freer play of competitive forces" in the area of oil pipeline ratemaking (584 F.2d at 413). Yet in *Farmers Union II*, the same Court of Appeals abandoned this focus and set aside the FERC's methodology, which reflected a serious, good-faith attempt to comply with the court's mandate. The Court of Appeals reached this conclusion on the basis of its un-

elaborated statement that the FERC's findings concerning competition were based on "anecdotal" evidence (App. A-44 to 45 n.50). In fact, there was substantial record evidence of effective competition in the oil pipeline industry,[6] and it was clearly within the province of the FERC to form an expert judgment based on such evidence. The Court of Appeals was not entitled to substitute its judgment as to the adequacy of the evidence and the competitive nature of the industry for the well-supported findings of the FERC.

Fourth, the Court of Appeals' refusal to accept the FERC's basic approach to oil pipeline regulation is attributable in large measure to its misinterpretation of the Hepburn Act and its legislative history. When Congress subjected oil pipeline rates to Federal regulation, it did not, as the Court of Appeals concluded, intend that oil pipeline rates must necessarily be regulated in the same manner and to the same degree as traditional public utilities (App. A-36). As the FERC explained in the course of its extensive analysis of the statutory materials, *and as this Court has expressly concluded*, the purpose of the Hepburn Act was to insure non-discriminatory access to pipeline transportation to small, non-integrated oil producers. *See United States* v. *Champlin Refining Co.*, 341 U.S. 290 (1951); *The Pipe Line Cases*, 234 U.S. 548 (1914).[7] Nothing in the legislative history supports

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[6] The evidence of record before the FERC showed that, consistent with the intent of Congress, the oil pipeline industry as it has evolved is pervasively competitive. The rates which oil pipelines charge are constrained by competition from other common-carrier oil pipelines (including competition between crude and product lines) and other modes of transportation, as well as by geographic or source competition and competition from private lines and intercompany exchanges, which can substantially reduce or even eliminate the need for oil pipeline transportation (LeGrange Ex. 8-1 at 12-21; McConnor, Ex. 9-1 at 4-9 and Ex. 9-2; Taylor, Exs. 12-1 to 12-9; Barber, Ex. 13-1 at 23-41; Jones, Ex. 1-1 at 12-29 and Exs. 1-2 to 1-7; Doran, Ex. 32-1 at 6-24).

[7] As this Court explained in *Champlin Refining, supra*, 341 U.S. at 297:

[Continued]

the Court of Appeals' conclusion that a cost-based public utility standard of reasonableness is required as a matter of law.

In sum, the Court of Appeals' rejection of the approach to oil pipeline regulation adopted by the FERC constitutes an improper and unlawful effort to impose traditional public utility concepts of ratemaking on a competitive industry in which the FERC, consistent with its statutory directives and the mandate of the Court of Appeals in *Farmers Union I*, has found that such a public utility approach is not appropriate. In so ruling, the Court of Appeals not only turned its back on its previous decision in this case, but flouted settled principles of administrative law that make clear that the choice of a rate methodology, including the rejection of lowest-cost, public utility ratemaking principles, is to be left to the agency to decide in its expert discretion.

The Court of Appeals also erred in concluding that the FERC's decision to implement its basic approach to oil pipeline regulation by (1) continuing in effect the traditional valuation rate base methodology,[8] and (2) adopt-

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[7] [Continued]

"The statute cannot be divorced from the circumstances existing at the time it was passed, and from the evil which Congress sought to correct and prevent . . . . Small independent producers—who lacked the resources to construct their own lines, or whose output was so small that a pipe line built to carry that output alone would be economically unfeasible—were in a desperate competitive position. There is little doubt, from the legislative history, that the Act was passed to *eliminate the competitive advantage which existing or future integrated companies might possess from exclusive ownership of a pipe line*" (emphasis supplied).

[8] As Intervenor-Respondent before the Court of Appeals, AOPL sought to defend the FERC's decision to continue the use of a valuation rate base methodology for this industry. However, as Petitioner, AOPL contended that the FERC had acted unlawfully in declining to make improvements in certain details of the traditional valuation in accordance with AOPL's suggestions, which the FERC *acknowledged* were meritorious. Although the Court of Appeals

ing an entrepreneurial rate of return methodology, lacks a reasoned basis.

The Court of Appeals' rejection of the FERC's rate base analysis is predicated on the principle that "an agency has a duty to consider responsible alternatives to its chosen policy and to give a reasoned explanation for its rejection of such alternatives" (App. A-51). However, as the court's own discussion of the FERC's decision acknowledges, *this is precisely what the FERC did* (App. A-51 to 67); an important part of the analysis that led the FERC to continue using a valuation rate base methodology was its determination that the principal alternative to the existing methodology, a system based on original cost, would be unsuited to the oil pipeline industry (*see* pp. 5-8, *supra*).

Moreover, an equally important part of the FERC's analysis was its affirmative determination that the valuation rate base methodology *is suited* to this industry—*inter alia,* because the fundamental purpose of oil pipeline regulation requires that the inquiry extend beyond matters of costs (App. B-191 to 193), and because oil pipelines do not enjoy protected utility markets that place a floor on earnings as a "quid pro quo" for cost-based regulation (App. B-104 to 107; B-227). In view of the latter factor, which makes "the [oil pipeline] investor's chance of actually collecting the [return] that the regulators want him to have . . . slimmer than it is in other regulated industries," the FERC found "the case for an inflation-sensitive oil pipeline rate base strong" (App. B-227). The Court of Appeals totally disregarded these and other affirmative findings as to the suitability of a valuation rate base methodology.

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agreed with AOPL that the FERC acted contrary to the requirements of the Administrative Procedure Act in declining to make the suggested improvements (App. A-67 to 73), it expressly "emphasize[d] that this holding does not go to the wisdom or efficacy of the ICC rate base formula" and that, in its judgment, the FERC's decision "does not provide a cogent defense of it" (App. A-71). It is in this latter respect that AOPL takes exception to the Court of Appeals' decision.

The essential basis for the Court of Appeals' criticism of the FERC's adoption of a valuation rate base, notwithstanding the FERC's hard look at original cost alternatives, is that the FERC failed to convince the Court of Appeals that the problems the agency found to be inherent in an original cost methodology are *sufficiently compelling* to preclude adoption of that methodology, and that such problems—for example, the problem of "front-end load" (*see* p. 8, *supra*)—could not somehow be cured. The Court of Appeals' analysis is thus based upon the presumed preferability of an original cost rate base methodology and the correlative premise that any departure from such a methodology must be explained and justified in detail. As shown above, that premise is not only unfounded, but is completely at odds with the Court of Appeals' decision in *Farmers Union I* and with the principles articulated by this Court in *Hope Natural Gas* and other cases that agencies are not bound to use any particular regulatory methodology and that a methodology is to be judged by its results.

The Court of Appeals' conclusion that the FERC's decision to adopt an entrepreneurial rate of return methodology lacks a reasoned basis similarly intrudes upon the lawful discretion of the FERC, and betrays the assumption that the validity of any regulatory methodology must be assessed by reference to the methodology used in the regulation of public utilities.

The first criticism advanced by the Court of Appeals is that the FERC's analysis disregarded the factor of risk, contrary to conventional principles of rate of return analysis (App. A-76 to 78). In fact, the FERC's decision analyzes at length the factors constituting the primary indicia of business risk—in particular, competition and other forces of the marketplace that preclude assurances of earnings at whatever level regulation might allow, but cannot guarantee (App. B-219 to 220, B-227). Moreover, the FERC's decision does not reject the comparable risk/comparable earnings standard for rate of return determinations, but instead rejects the particular

methodology by which that standard has been implemented in the very different context of public utility regulation because the FERC specifically found that such a methodology (which may replicate the investment decision process of conservative institutional or individual investors in public utilities) would be inappropriate, unrealstic, and unworkable if applied to oil pipelines (*see* pp. 8-9, *supra*).

The Court of Appeals' second criticism of the FERC's rate of return analysis—*i.e.*, that the methodology adopted does not properly adjust for the effect of inflation on the rate base (App. A-78 to 81)—is based upon a similar misconception. Contrary to the Court of Appeals' underlying assumption, the valuation rate base is not intended to "track inflation" but to reflect current values of oil pipeline assets. Moreover, the flexibility allowed by the FERC in determining a rate of return standard and an appropriate deduction from the applicable rate of return to reflect rate base write-ups, is entirely consistent with the FERC's clearly articulated intent that oil pipeline investment be encouraged by allowing the opportunity to realize returns consistent with those being realized in competitive markets (*see* p. 9, *supra*).

The Court of Appeals' final criticism of the entrepreneurial rate of return approach adopted by the FERC is that the "equity component" of the valuation rate base bears no "meaningful relation to . . . rates of return on book equity" (App. A-81) and would somehow result in "double counting" because the "FERC includes the *entire* appreciation on the rate base—attributable to *both* the equity and debt components of the pipeline—in its 'equity component' " (App. A-83). This criticism likewise evinces a doctrinaire adherence to original cost, public utility concepts, and a resulting inability to acknowledge that valuation is an *asset* concept. As the FERC recognized in its decision, "equity" represents the interests of an owner in its asset. In the competitive sector of the market, an owner of an asset is entitled to the full apprecia-

tion in the value of that asset as a result of inflation or other factors. As the FERC also recognized, this holds true whether the asset was financed with equity or with borrowed money (debt) (App. B-281 to 283). In the unregulated competitive sector of the economy, as the FERC found, the equity owner receives the entire increase in the current value of an asset, and is not obligated to share with a lender of debt capital any part of the appreciated value in the assets (*id.*). The FERC concluded that "we think the unregulated competitive sector [is] a better model to follow and a wiser guide to decision than specialized public utility notions" (*id.*). This conclusion was clearly within the scope of the FERC's discretion under the mandate of *Farmers Union I*, and should not have been disturbed by the Court of Appeals.

III. THE COURT OF APPEALS' AFFIRMANCE OF THE FERC'S RULING ON THE TREATMENT OF DEFERRED TAX AMOUNTS IS PLAINLY ERRONEOUS

Until 1954, taxpayers were generally required to compute depreciation for Federal income tax purposes by using the straight-line method, which spreads the cost of a depreciable asset evenly over its useful life. In 1954, Congress changed the law to permit most businesses, including oil pipelines, to take greater amounts of depreciation for tax purposes in the early years of a new asset's life by using "accelerated" depreciation deductions resulting in lower taxes paid during the early years of an asset's life, and smaller deductions resulting in higher taxes paid during the later years of an asset's life. Although the aggregate amount of taxes payable over the life of an asset remains unchanged, the use of accelerated depreciation permits a taxpayer to defer taxes from early years to the later years of an asset's life.

The investment incentive created by accelerated depreciation results from the time value of money—*i.e.*, a dollar received sooner is more valuable than one received later. In economic terms, this benefit consists of the tax-

payer's opportunity to reinvest and earn a return on the deferred tax payments during the period in which those payments are deferred. The opportunity to receive this economic benefit—the value of the use of the deferred tax amounts—creates an incentive for firms to make certain investments in productive assets which would not otherwise have been made. By authorizing accelerated depreciation and thus creating this benefit, Congress intended to encourage oil pipelines and other businesses to expand their productive capacity and create new jobs (*see, e.g.*, H.R. Rep. No. 1337, 83d Cong., 2d Sess. 24 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 26 (1954)).

In computing Federal income tax expense for ratemaking purposes, there are two possible methods of accounting for the effects of accelerated depreciation. Under the first method, "flow through," the regulated entity is permitted to charge as a cost of service only the amount of taxes actually paid in a given year. If the entity's actual tax liability is reduced by accelerated depreciation, then the amount of taxes chargeable to ratepayers is reduced by a corresponding amount. "Flow through" ratemaking is so called because, using this method, the regulated entity "flows through" the tax benefits to ratepayers in the form of lower rates.

In its decision reviewed by the Court of Appeals, the FERC held that oil pipelines should be permitted to use an alternative method of accounting for the effects of accelerated depreciation—*i.e.*, "normalization" of the resulting tax timing differences. Under this approach, an oil pipeline is permitted to charge as a cost of service the full amount of taxes that would be payable each year at the statutory tax rate (*i.e.*, the rate that would have been paid by the company if the company had not elected to use accelerated depreciation). Because, as noted above, taxes actually paid in the early years of the life of an asset will be lower than the statutory rate where accelerated depreciation is elected, normalization confers (or should confer) a temporary benefit to the company—the use of (and return on) the deferred tax amounts

during the deferral period. Hence, as the FERC found, the normalization approach provides a "pro-investment tilt to the taxation of business income" as intended by Congress in enacting the accelerated depreciation provisions of the tax code (App. B-305).

However, having thus concluded that normalization of deferred taxes is required as a matter of Congressional intent, the FERC held that a deduction must be made from the valuation rate base reflecting the amount of deferred tax reserves—completely disregarding unrebutted evidence of record that deduction of the deferred tax amounts from the rate base would completely eliminate any benefits that would otherwise result from a carrier's election of accelerated depreciation for income tax purposes (App. B-303 to 304). As a result of the rate base deduction requirement, the incentive to elect accelerated depreciation for tax purposes would be eliminated, and the carriers would be better off by electing straight line treatment. The pro-investment incentive intended by Congress would thus be totally eliminated.

On these grounds, AOPL petitioned the Court of Appeals below to review this aspect of the FERC's decision, explaining that the agency's stated justifications of this result were wholly without merit.

First, AOPL explained that, contrary to the FERC's conclusion that it would be unfair to require shippers to pay a return on funds they had supposedly contributed to the carriers (App. B-303), deferred tax amounts represent funds supplied not by shippers but by the U.S. Treasury (in the form of deferred tax receipts) to provide an incentive for capital investment for companies electing to use accelerated depreciation.

Second, AOPL explained that, contrary to the FERC's apparent belief (App. B-303 to 304), no requirement that deferred tax amounts resulting from tax timing differences be deducted from rate base is imposed by the Internal Revenue Code, or by the applicable case law.

The FERC correctly found that Congress made the (temporary) benefits of accelerated depreciation available to oil pipelines for the same reason that it made available the (permanent) benefits of investment tax credits—*i.e.*, to stimulate investment. In addition, the FERC properly declined to require the deduction of *investment tax credit* amounts from the rate base because Congress provided by statute that as to non-public utilities, such as oil pipelines, Federal agencies are prohibited from using investment tax credits "for the purpose of establishing the cost of service . . . or *to accomplish a similar result by any other method*" (quoting Revenue Act of 1964, Pub. L. 88-272, 78 Stat. 41, § 203(e); emphasis supplied). However, the FERC justified the requirement that *deferred tax amounts* be deducted from the rate base, notwithstanding that such deduction completely removes the investment incentive intended by Congress, because Congress did *not expressly* prohibit such result by statute as it did with respect to investment tax credit amounts. Hence, the theory underlying the FERC's reasoning is that Congress' intent in enacting legislation can be frustrated indirectly by the actions of an administrative agency so long as Congress has not expressly prohibited such actions. Such a theory of statutory construction, as AOPL argued to the Court of Appeals, is wholly unsupportable.

As to the applicable case law, AOPL argued that the only court that has squarely addressed the issue of the proper rate base treatment of deferred tax amounts—the Court of Appeals for the Third Circuit—*upheld* as being within the agency's discretion a determination of the ICC that deduction of deferred tax amounts is not appropriate because it would contravene Congressional intent. *Bessemer and Lake Erie Railroad Co.* v. *ICC*, 691 F.2d 1104, 1116 (3d Cir. 1982), *aff'g Standards for Railroad Revenue Adequacy*, 364 I.C.C. 803 (1981), *cert. denied*, 103 S. Ct. 2463 (1983).[9]

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[9] In its decision, the FERC sought to rely upon a decision of the Court of Appeals in *San Antonio, Texas* v. *United States*,

Finally, AOPL explained the fallacy underlying the FERC's finding that normalization coupled with rate base deduction would enhance carrier cash flow, and that members of the industry would somehow benefit therefrom (App. B-304). The *only* benefit to enhanced cash flow is the ability to *use* it—*i.e.*, the opportunity to earn on it—and the carriers have been denied any such benefit by the FERC's action, contrary to the purpose of Congress to stimulate investment.

In its decision, the Court of Appeals did not address *any* of the findings and determinations of the FERC as to the issue of the appropriate rate base treatment of deferred tax amounts. Instead, the Court of Appeals affirmed the FERC's decision on the novel ground that oil pipelines benefit from accelerated depreciation under normalization accounting *even if* deferred tax amounts are required to be deducted from the rate base on the

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631 F.2d 831, 847 (D.C. Cir. 1980), to the effect that exclusion of deferred tax amounts from a regulated entity's rate base is "an essential component of an agency's election to normalize taxes for ratemaking purposes" (B-303 to 304). However, in *San Antonio,* the Court of Appeals for the D.C. Circuit set aside a decision of the ICC declining to require rate base deduction of deferred tax amounts for railroads on the ground that it was then the stated policy of the ICC to require such a deduction and that the ICC had departed from that policy without explanation (631 F.2d at 847). Thus, the *San Antonio* decision, properly read, stands for no more than the proposition that an agency may not adopt or depart from a ratemaking policy without providing a reasoned explanation for doing so. That decision cannot properly be read to require rate base deduction of deferred tax amounts. Indeed, as noted above, since the *San Antonio* decision, the ICC itself has held that rate base deduction of deferred tax amounts is not appropriate because it would contravene Congressional intent and in so holding has been upheld on judicial review by the Third Circuit in *Bessemer, supra.*

In a subsequent decision, the Court of Appeals, making reference to its decision in *San Antonio,* expressly declined to reach the question of whether the ICC and the *Bessemer* court "in ruling on reserves for deferred taxes, paid insignificant attention to a decision that remains the law of this circuit." *Western Coal Traffic League* v. *ICC,* No. 82-1837, slip op. at 7 (D.C. Cir. May 22, 1984).

premise that the companies can earn on these amounts *notwithstanding* that requirement. The Court of Appeals noted that unregulated companies that "do not concern themselves with rate bases," but nonetheless choose accelerated depreciation "solely because it permits them to defer a tax burden" (App. A-91). The Court of Appeals reasoned that, similarly (*id.*): "The oil pipeline companies that choose normalization accounting also enjoy the benefit of tax deferral. The amount in the resulting deferred tax account can earn interest even if it is not included in the rate base." On this basis alone, the Court of Appeals "reject[ed]" AOPL's contention that deduction of deferred tax amounts from rate base eliminates any benefits of normalization intended to be conferred by Congress.

The holding of the Court of Appeals is manifestly erroneous as a result of the court's failure to recognize that funds are of value to a business only to the extent that it is permitted an opportunity to earn on those funds.[10] If a carrier's rate base is reduced by the amount of deferred tax reserves, then the carrier is deprived of the opportunity to earn a return on such amounts, rendering them valueless.

In sum, the rate base deduction requirement imposed by the FERC deprives oil pipelines of the opportunity to earn a return on the deferred tax amounts resulting from accelerated depreciation, and thus deprives these companies of the benefits that Congress intended to confer. The Court of Appeals' affirmance of the Commission's

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[10] The Court of Appeals' statement that unregulated companies "do not concern themselves with rate bases," and "choose accelerated depreciation solely because it permits them to defer a tax burden" is seriously misleading. Although unregulated companies may not be concerned with "rate bases" per se, they are obviously concerned with the investments in tangible and intangible assets that provide earnings. Moreover, the *only* value of the deferral of taxes is the use of the funds that are temporarily available. If the earnings on such amounts are somehow precluded, the deferral is valueless to unregulated as well as regulated companies.

decision in this respect is based upon a wholly erroneous premise and would clearly undercut the purpose of the tax deferral—the creation of investment incentives. For this reason as well, the requested writ of certiorari should issue.

CONCLUSION

For the foregoing reasons, certiorari should be granted and the case set for briefing and oral argument.

Respectfully submitted,

CHARLES E. GRAHAM
JOHN E. COMPSON
KENNETH P. FOUNTAIN
JAMES R. KINZER
HARRY L. REED

SIDLEY & AUSTIN
Of Counsel

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R. EDEN MARTIN *
LAWRENCE A. MILLER
VINCENT F. PRADA
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

PATRICK H. CORCORAN
1725 K Street, N.W.
Washington, D.C. 20006
Attorneys for Petitioner
Association of Oil Pipe Lines

* Counsel of Record